

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 98-029

November 19, 1998

RICHARD CLARK, et al. v.
NORTHERN UTILITIES, INC.,
Petition to Require Commission
Investigation of Unreasonable
Acts or Practices Regarding
Cost of Gas

ORDER

WELCH, Chairman, NUGENT and DIAMOND, Commissioners

I. SUMMARY OF ORDER

We dismiss this complaint because we find that the complainant's allegations, that certain acts and practices related to Northern Utilities, Inc.'s (Northern) precedent agreement with Granite State Gas Transmission Company (Granite) for liquefied natural gas (LNG) storage and delivery service are unreasonable, are without merit. Nevertheless, we require Northern to report periodically on the contractual status of, and justification for, its decisions relating to this resource.

II. PROCEDURAL HISTORY

On January 16, 1998, Richard Clark filed a complaint signed by 17 persons pursuant to 35-A M.R.S.A. § 1302. The cover letter states that all signatories are natural gas customers of Northern.

On January 19, 1998, the Administrative Director issued a Notice of Complaint requiring Northern to file its response within ten days. On January 29, 1998, Northern filed its response. The Office of the Public Advocate filed its petition to intervene pursuant to 35-A M.R.S.A. Section 1702 on January 28, 1998. On February 12, 1998, Richard Clark filed the petitioners' reply to Northern's response.

The Hearing Examiner issued a Proposed Order on October 9, 1998 for parties' comments. The Commission deliberated on October 19, 1998.

III. BACKGROUND

This complaint was filed during the pendency of the Federal Energy Regulatory Commission's (FERC) review of Granite's request for a certificate of public convenience and necessity¹ for authorization to construct and operate a 2 billion cubic foot (Bcf) LNG facility in Wells, Maine. The sole purpose of the facility was to provide storage, withdrawal, and injection services to Northern, an affiliated local distribution company (LDC) serving in Maine and New Hampshire. The project had been under review by FERC since November 1994. The FERC issued a Preliminary Determination of Need on January 29, 1996.

The Maine Commission issued an Order on August 9, 1996 approving a proposed Precedent Agreement between Northern and Granite for purchase of the entire capacity of the 2 Bcf facility for a term of 20 years. See Order, Northern Utilities, Inc., Proposed Precedent Agreement with Granite State Gas Transmission, Inc. For LNG Storage Service, Docket No. 95-480, and Northern Utilities, Inc., Proposed Precedent Agreement with Portland Natural Gas Transmission System for Transportation Service, Docket No. 95-481, (Aug. 9, 1996) (the August 9th Order).

Beginning in July 1996, as a result of local opposition, the FERC conducted a comprehensive study of possible alternative site locations throughout Maine, New Hampshire, and Massachusetts. In February 1997, the FERC staff issued a Supplemental EIS finding that none of the 65 alternative site locations studied was preferable to the Wells location.

NO TANKS, an organization of local residents opposing the construction of the facility, appealed the Maine Commission's order to the Maine Supreme Judicial Court (SJC). The SJC denied the appeal and upheld the Commission decision. See No Tanks, Inc. v. Public Utilities Commission, 697 A.2d 1313 (Me. July 23, 1997).

FERC staff issued a Final Environmental Impact Statement (EIS) recommending approval of the project in July 1997.

In response to a September 23, 1997 request of NO TANKS, and following failed settlement negotiations, the FERC heard oral argument in January 1998 on whether to grant a certificate to the project. In March of 1998, FERC decided to hold hearings on the issue of market need for the facility. FERC held hearings in April 1998 to determine "whether viable alternatives exist for the peak shaving service needed by Northern Utilities and if so

¹Pursuant to Section 7(c) of the Natural Gas Act.

at what cost." See Order Establishing Hearing Procedures, Docket No. CP96-610-000 (FERC March 11, 1998).

On May 27, 1998, the FERC approved the project, finding sufficient need for the facility. See Order Issuing Certificate, Docket No. CP96-610-000 (FERC May 27, 1998). On September 30, 1998, FERC denied requests for rehearing filed by local opponents (including some of the petitioners) on issues raised in this complaint and others. See Order Clarifying Certificate Order and Denying Rehearing, Docket No. CP96-610-000 (FERC Sept. 22, 1998).

IV. COMPLAINT AND RESPONSES

A. Complaint

The petition requests that the Commission investigate Northern's commitment to its affiliate, Granite, for LNG storage services from Granite's proposed facility in Wells, Maine. The petitioners allege that Northern's commitment to Granite -- under the terms of a Precedent Agreement approved by this Commission on August 9, 1996 and considering possible supply alternatives -- constitutes an unreasonable act or practice. The petitioners request that the Commission take all necessary action to satisfy their complaint.

Specifically, petitioners allege that:

- Northern has failed to justify its commitment to purchase LNG services from Granite as the lowest cost service option for either its baseload or peak shaving needs.
- Northern's commitment to purchase LNG storage and withdrawal services from Granite's proposed facility will result in much higher rates for Northern's rate payers in both the short and long term than would other supply alternatives.
- Northern's commitment to purchase LNG services from Granite is unnecessary to ensure a reliable gas supply given 1) the earlier in-service dates of the Portland Natural Gas Transmission System (PNGTS), Maritimes & Northeast Pipeline (MNE), and the PNGTS/MNE Joint Facilities; 2) the large quantities of gas carried by those pipelines; and 3) the recent extension of

Granite's lease of the Portland Pipe Line
(PPL).

The first two allegations relate to the reasonableness of costs and rates resulting from Northern's purchase pursuant to the terms of the present agreement. The third allegation relates to the need for the LNG supply.

B. Northern's Response

Northern responds that the petitioners' claims are without merit and requests that the Commission dismiss the complaint. In support of its position, Northern points out that its analysis of supply options, which included both the PNGTS and MNE pipelines, took into account cost as well as reliability, flexibility and viability. Northern also points out that its decision to enter the Precedent Agreement was presented to the Commission in Docket Nos. 95-480/481, and thoroughly reviewed and approved in support of its proposal to enter into the Precedent Agreement with Granite which is the subject of this complaint. Northern asserts that no additional review of the Precedent Agreement is warranted at this time because all of the issues raised by petitioners were thoroughly investigated in Docket Nos. 95-480/481. See August 9th Order. Moreover, Northern notes that the Maine Supreme Judicial Court affirmed the Commission's decision, finding sufficient evidence to support it. Finally, Northern cites oral argument before the FERC in early 1998 outlining the overall economies and benefits of the project to Northern. For these reasons, Northern argues that the cost benefits of its commitment to this supply have been thoroughly analyzed and do not need to be revisited.

C. Petitioner's Reply

The petitioners filed a reply to Northern's response to the complaint, arguing that the analysis of supply options undertaken in Docket Nos. 95-480/481 was flawed in the following respects:

- Northern did not issue an RFP initially but simply contracted with its affiliate, Granite;
- Northern rejected MNE's assertion that its pipeline would be available as an alternative supplier in 1998;
- Northern has not adequately demonstrated that the proposed LNG facility is a more reliable or flexible supply option than pipeline supplies.

Petitioners request that the Commission require Northern to issue an RFP to pipeline sources and storage facilities to provide current cost data to enable it to determine that the facility will not impose a stranded cost burden on Northern's rate payers.

V. ANALYSIS

A. Cost and Rates

Petitioners allege that Northern has not justified its commitment to purchase LNG services from Granite on the basis of cost. In particular, petitioners allege that Northern has not demonstrated that the cost of this supply is the lowest cost service option for either its baseload or peak shaving needs. In addition, petitioners allege that Northern's commitment to purchase LNG services from Granite under the present agreement will result in higher rates for Northern's rate payers in both the short and long term than would other supply alternatives.

The petitioners' allegations are without merit. Northern is correct that these issues were extensively reviewed in Docket Nos. 95-480/481 and, on the basis of that record, Northern's purchase of LNG services from Granite was found to be reasonable and prudent.

Specifically, in Docket No. 95-480/481, we reviewed Northern's proposal to purchase LNG supply from Granite under the terms of the Precedent Agreement to determine whether the arrangement was reasonable and not adverse to the interests of rate payers and the public. Our review of affiliated interest transactions is required under 35-A M.R.S.A. §707.²

Northern presented evidence to demonstrate that the cost of the proposed LNG supply was reasonable and that no other option appeared to be preferable given the circumstances known and reasonably assumed at that time. Northern provided resource portfolio computer modeling optimization reports which identified Northern's optimal resource selections. These resources were chosen by the model on the basis of historic and projected load,

²In conducting that review, we were mindful that the Commission's regulatory purpose is to "assure safe, reasonable, and adequate service at rates which are just and reasonable to customers and public utilities." See 35-A M.R.S.A. §101. Cost is one of several factors to be considered in finding an arrangement, rate, or practice reasonable. Costs and rates must be reasonable, not necessarily the lowest possible.

and cost. Despite substantial uncertainty as to service price, in-service dates, and even whether the PNGTS and MNE pipelines would be approved and constructed by the date Northern expected to require additional supply, they were included in the analysis as alternative supplies.

The model selected 34,100 Dekatherms per day (Dth/day) of baseload supply from PNGTS and .9 Bcf of LNG storage services to provide peaking supply as the optimal supplies for Northern over the 20-year term to meet the projected needs of firm sales service customers. See August 9th Order at 13. This selection indicated that these supplies were optimal with regard to type (baseload or peaking), quantity, and cost. The Commission adopted this evidence as persuasive support for Northern's proposal to contract to purchase baseload supply from its affiliate, the PNGTS pipeline, and storage, withdrawal and injection services (i.e. peaking supply) from another affiliate, Granite. Id. at 49.

However, the Commission rejected Northern's Precedent Agreement with PNGTS as proposed because it required Northern to purchase nearly twice the amount that the computer modeling selected as optimum baseload supply over the planning horizon. Id. at 10, 24. Northern later submitted, and the Commission approved, a revised Precedent Agreement with PNGTS for the optimal amount, 34,000 million Btu (MMBtu) of 151-day baseload supply and 1,100 MMBtu of 365-day supply for a term of 20 years. See Northern Utilities, Inc., Proposed Precedent Agreement with Portland Natural Gas Transmission System for Transportation Services, Docket No. 96-558, Order (Dec. 19, 1996). See also Northern Utilities, Inc., Firm Transportation Agreements With Portland Natural Gas Transmission System, Order (March 30, 1998), (the Commission approves final contracts, i.e. Firm Transportation Agreements, between Northern and PNGTS).

The Commission also approved Northern's proposed Precedent Agreement with Granite for the entire capacity of its 2 Bcf facility despite the fact that the computer resource optimization model selected only .9 Bcf of LNG supply as Northern's optimal long-term peaking resource because of its concerns about a possible short-term baseload supply shortage. See August 9th Order at 48-49. Because PNGTS was not proposed to be in service until November 1, 1998 and Northern's lease with the Portland Pipe Line would expire on April 30, 1997, it was apparent that Northern would suffer a serious supply shortage without an additional short-term source of baseload supply. Accordingly, the Commission considered evidence on Northern's potential supply alternatives and found that the LNG facility could provide the necessary short-term baseload supply as well as

optimal long-term peaking supply to Northern at a reasonable cost. Id. at 48.

In addition, given that nearly half of the capacity of the LNG facility would be in excess of Northern's peaking needs over the long term, we sought assurances from Northern that its excess capacity could be resold at an advantageous price so that Northern's rate payers would not be burdened with high costs over the long term in return for this short-term supply insurance. Northern and Granite presented a series of agreements with Gaz Metropolitan and Company, Limited Partnership (GMLP) which, if executed, would sell or transfer ownership of the excess capacity to GMLP for a price that would result in lower costs to Northern's rate payers than if Granite built a 1 Bcf facility to more closely fit Northern's long-term peak supply needs. See August 9th Order at 26, n.8.

We approved the Precedent Agreement between Northern and Granite based on our conclusion that it offered a reasonable and prudent supply option given the circumstances existing at that time. The Supreme Judicial Court upheld our Order finding that substantial evidence existed to support the decision. See No Tanks at 1316.

The Precedent Agreement was approved based on findings that explicitly refute the Petitioners' allegations as to cost and rates. Accordingly, we find the complaint without merit with respect to these allegations.

B. Necessity

The third allegation Petitioners make is that Northern's proposed commitment to purchase LNG services from Granite is unnecessary due to the availability of supply from pipeline alternatives as well as the recent Portland Pipe Line (PPL) lease extension. Petitioners also argue that Northern should have issued a request for proposal (RFP) initially to obtain bids for this supply rather than simply contracting with its affiliate, that Northern unreasonably rejected MNE's assertion that it would be in service in November 1997, and that Northern has not adequately demonstrated that the LNG services are a more reliable and flexible supply option than are pipeline supply alternatives.

1. MPUC Review

Again, we reviewed several of these points -- whether Northern's proposed agreement with its affiliate, Granite, was adverse to the public interest and whether Northern could reasonably rely on MNE's assertions that its pipeline would

be available as a supply alternative for the 1997-1998 winter season -- in Docket Nos. 480/481. Our findings on these issues were sustained by the Maine Supreme Judicial Court. See No Tanks at 1316.

Petitioners also allege that the extension of the Portland Pipe Line lease has made the LNG supply unnecessary for Northern. This is without merit.

It is fortunate for rate payers that Northern has averted a baseload supply shortage during the two-year FERC review of the LNG project by obtaining lease extensions for use of the Portland Pipe Line through the 1997-1998 and 1998-1999 winter heating seasons. When we reviewed Northern's supply options in Docket Nos. 95-480/481, it appeared that further extensions would not be possible because of the pipeline's owners' intention to reconvert the pipeline to oil transport. The extensions have been obtained only on increasingly expensive terms that require Granite (and thus, Northern) to pay increased costs for its use and to pay for or make certain retrofits to advance the conversion of the line each year. See Granite State Transmission, Inc., FERC Docket Nos. RP97-8-000, RP98-205,000, TM99-1-4-000. It is apparent that these extensions are not limitless either in terms of the time for which they can be obtained or in terms of the cost to Granite (and thus, Northern's rate payers) of obtaining them.

These extensions, while fortuitous as a short term baseload supply stop gap measure, are not a long term solution to Northern's base and peak supply needs. The use of PPL has never been proposed as a viable long-term peak supply alternative for Northern given its capacity limitations and other characteristics. Moreover, with PNGTS now under construction and expected to be in service during this winter's heating season, there will be no further need to obtain costly PPL lease extensions.

2. FERC Review

Additionally, the FERC reviewed the remaining points in its proceeding to determine whether the public convenience and necessity would be served by allowing Granite to build the proposed LNG facility. In response to petitioners' concerns that the LNG supply was not a cost-effective or necessary supply resource for Northern given the passage of time, FERC held a hearing in April 1998, to review the results of an RFP Northern issued to test the market for alternative peak supplies. The FERC heard and considered arguments as to whether the RFP was adequate and whether the LNG facility would provide Northern with any benefits over those available from other

pipeline and storage alternatives. The FERC explicitly found that the LNG facility proposed for Wells, Maine, because of its location and the nature of LNG injection into Northern's distribution system, would provide greater reliability and operational flexibility for Northern than would pipeline alternatives. See Granite State Gas Transmission System, Application for Certificate of Public Convenience and Necessity, FERC Docket No. CP96-610-000, Order Issuing Certificate (May 27, 1998) at 17.

There is no merit in Petitioners' request that we revisit these issues. If the Petitioners are dissatisfied with the FERC's review or conclusions, the proper recourse is for the Petitioners to seek reconsideration of the determination by the FERC on these points. A further investigation of these issues by us is unnecessarily redundant and without legal effect with respect to the FERC's decision.

C. Stranded Costs

Finally, Petitioners request that the Commission require Northern to issue an RFP to pipeline sources and storage facilities to obtain current bids for alternative peaking supplies. Petitioners seek to have the Commission determine that Northern's commitment to purchase peaking supplies from Granite's facility will not impose large stranded costs on rate payers.

Our Order in Docket Nos. 95-480/481 explicitly stated that we would monitor Northern's resource portfolio management and that imprudent costs would not be allowed in rates. Moreover, the order indicated that by approving the Precedent Agreement, we are not constrained in making future determinations as to whether Northern would be entitled to recover stranded costs associated with supply. See August 9th Order at 28. Any future review of Northern's resource management activities is subject to these considerations. Moreover, any future contractual commitment that Northern makes to Granite will be scrutinized and subject to disallowance if we determine it to be imprudent or a stranded cost properly borne by shareholders. All decision points (actions or inactions) since August 1996 will be subject to prudence review. To the extent that the terms of Northern's present agreement with Granite allows Northern to mitigate its stranded cost risk, we will hold Northern accountable if it fails to do so.

Based on representations made by Northern both during the FERC proceeding and subsequently, we understand that there is no need to require the Company to issue an RFP to solicit additional, current peak supply alternatives because Northern has already done so. We fully expect Northern to reassess its supply

options to determine whether its commitment to purchase the full capacity of Granite's proposed LNG facility continues to be prudent and in its rate payers' interests. If it concludes that its continued commitment to purchase LNG services from Granite is prudent, we expect Northern to negotiate (consistent with whatever opportunities exist under the Precedent Agreement) a final contract incorporating such revised terms for quantity and term as Northern determines are warranted by changes in its reasonably expected supply needs.

Changes may have occurred because the gas industry and its regulation are rapidly changing on many levels (i.e. federal, state, regional, and intra-company). For instance, given current circumstances, Northern no longer requires, nor can it expect, the LNG facility to provide it with a short-term stopgap baseload supply prior to PNGTS's being in service.³ Whether GMLP will, in fact, contract on terms advantageous to Northern and/or Granite to ensure that Northern's purchase of LNG supply from Granite will be a reasonable and cost-effective resource for its needs has not been confirmed. To the extent GMLP -- or another entity -- does not contract to relieve Northern of excess supply on advantageous terms, Northern's commitment to purchase 2 Bcf of LNG storage capacity for 20 years may not be economically justified.

The range of cost-effective, long-term supply alternatives may have changed over the intervening two years. Northern may have to reassess its future peak needs in light of the current move to unbundle commodity from transportation service and the uncertainty as to how long-term supply commitments that are stranded thereby will be recovered. Moreover, Northern's service expectations within Maine may have changed as a result of this Commission's recent decision to allow competition among local distribution company natural gas utilities. We express no opinion on whether any or all of these factors would justify or compel a different resource approach than that embodied in the Precedent Agreement. We merely emphasize that, to the extent Northern has flexibility with respect to its resource acquisition decisions, it must exercise its judgment prudently.

Finally, in light of legislation passed last session that puts shareholders at risk for all costs or obligations within the control of the gas utility incurred after March 1, 1998, that become uneconomic as a result of competition or deregulation, Northern may be required, on behalf of its

³The LNG facility will not be constructed and in service before 2001. See October 1998 letter to FERC from John Snow, President, Granite, FERC Docket No. CP96-610-000.

shareholders, to reassess its commitment to the purchase of the full capacity of the LNG facility. See Ch. 707 (L.D. 2094) 1997 Maine Legislature. We fully expect that Northern's management, acting prudently, will consider all of these factors in reassessing the quantity and term of its commitment to purchase peaking supply as it makes resource decisions. Certainly, we will investigate to determine whether Northern's resource decisions subsequent to August 1996 have been prudent if this issue is raised in a future case.

However, since Northern has not presented a final contract for our review,⁴ investigation into these matters would be premature at this time. Given that Northern may find a more suitable resource supply option and not seek to enter a final contract with Granite as originally proposed, an investigation at this time is unwarranted. Instead, we will examine the prudence of Northern's ongoing resource decisions if it becomes an issue in the future. Petitioners will receive notice of, and may participate fully in, any such review.

VII. REPORTING REQUIREMENT

In the meantime, to ensure that we are fully informed, we require Northern to report bi-monthly (starting December 30, 1998) on the following:

- whether it proposes to contract with Granite for LNG services,
- if so, whether it proposes to contract on the identical terms set forth in the Precedent Agreement presented to the Commission in July of 1996, or how the terms would differ,
- whether GMLP has committed to purchase the excess LNG services and storage capacity as outlined in the agreements presented to the Commission in July of 1996,
- if not, whether Northern has identified and contracted with other entities for LNG service and storage capacity in excess of its needs and at what price, and Northern's justification for going forward to contract with Granite for an amount in excess of its optimal peak supply needs.

VIII. CONCLUSION

⁴It is our understanding that Northern is currently assessing its alternative supply options.

For the foregoing reasons, we dismiss the petitioners complaint, finding it without merit.

Date at Augusta, Maine this 19th day of November 1998.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
 Nugent
 Diamond

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.
2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320 (1)-(4) and the Maine Rules of Civil Procedure, Rule 73 et seq.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320 (5).

Note:The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.